

LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS' PLAN 2 RETIREMENT BOARD

Purchase of Service Credit and Annuity Final Proposal

December 9, 2004

Issue

The Select Committee on Pension Policy recommended House Bill 2535 in the 2004 Legislative session providing the option to purchase service credit at the time of retirement by PERS Plan 2 and 3 and SERS Plan 2 and 3 members.

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Members Impacted

Purchase of service credit and annuity could potentially be an issue for any active LEOFF Plan 2 member.

Background Information and Policy Issues

The Purchase of Service Credit and Annuity was given initial consideration by the Board on March 24, 2004. A Preliminary Report was discussed by the Board on April 28, 2004.

A vested member of the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) Plan 2 may retire with an unreduced defined benefit at age 53. At retirement in Plan 2 a member receives 2 percent of the member's final average salary for each year of credited service.

A member of LEOFF Plan 2 may apply for early retirement after 20 years of credited service beginning at age 50. A member who applies for early retirement has his or her benefit reduced instead by 3 percent per year for the amount of time they retire prior to age 53.

Members of LEOFF Plan 2 generally have the opportunity to participate in deferred compensation plans. These plans permit an individual to place a portion of salary into a special account prior to being subject to payroll tax reductions. The Department of Retirement Systems (DRS) operates a deferred compensation program consistent with the

federal tax requirements of 26 United States Code section 457, commonly called a "457 Plan", in which employees of the state, counties, municipalities and other political subdivisions may participate. Some employers may also participate in other 457 plans or deferred compensation-type plans commonly referred to as "403(b)" or "401(k)" plans.

In recent years, changes in federal law have liberalized the rules on the transfer of funds between tax-deferred accounts, including government defined benefit pension plans like the LEOFF Plan 2, and deferred compensation accounts such as 457, 403(b), and 401(k) plans. Many state and local government pension plans have subsequently provided the opportunity for members to transfer funds, including funds from tax-deferred accounts, into these plans to add up to five years of service credit to a member's defined benefit.

Several Washington State pension plans currently have provisions that allow the purchase of service credit at retirement or the purchase of an annuity:

- House Bill 2535 was passed in the 2004 legislative session permitting members of the Public Employees' Retirement System (PERS) plan 2 and plan 3 and the School Employees' Retirement System (SERS) Plan 2 and Plan 3 who qualify for early retirement or alternate early retirement to make a one-time purchase of up to five additional years of service credit.
- RCW 41.50.088 provides members and survivors with self-directed investments in the Teachers' Retirement System (TRS) Plan 3, the School Employees' Retirement System (SERS) Plan 3, and the Public Employees' Retirement System Plan 3 optional actuarially equivalent life annuity benefit payment schedules that may be purchased from the combined plan 2 and plan 3 funds under RCW 41.50.075.
- RCW 41.32.067 provides Teachers' Retirement System (TRS) Plan 1, Plan 2 and Plan 3 members the ability to purchase additional benefits in the form of an annuity by making a member reserve contribution which is actuarially converted to a monthly benefit at the time of retirement.

Policy Options

Policy Option 1: Purchase of Service Credit

A member who applies for retirement in LEOFF Plan 2 may, at the time of retirement purchase up to five years of additional service credit. The cost of the additional service credit would be the actuarial equivalent value of the resulting increase in the member's benefit. The member may pay all or part of the cost of the additional service credit with an eligible transfer from a qualified retirement plan.

Policy Option 2: Purchase of Annuity

A member, or survivor of a member who applies for retirement benefits from LEOFF Plan 2 may, at the time of application purchase an actuarially equivalent life annuity from the LEOFF Plan 2 retirement fund. The member may pay all or part of the cost of the annuity purchase with an eligible transfer from a qualified retirement plan.

Estimated Fiscal Impacts

Option 1 and Option 2 are actuarially neutral and would not increase the cost of the plan.

Supporting Information

- House Bill 2535 - Final Bill Report
- RCW 41.50.088
- RCW 41.32.067
- WAC 415-02-340
- Z-0188 Purchase of Additional Service Credit
- Z-0189 Purchase of Additional Service Credit and Annuity

FINAL BILL REPORT

HB 2535

C 172 L 04
Synopsis as Enacted

Brief Description: Permitting members of the public employees' retirement system plan 2 and plan 3 and the school employees' retirement system plan 2 and plan 3 who qualify for early retirement or alternate early retirement to make a one-time purchase of additional service credit.

Sponsors: By Representatives Alexander, Fromhold, Conway, Rockefeller, G. Simpson, Kessler, Moeller, Chase, Bush and Armstrong; by request of Select Committee on Pension Policy.

House Committee on Appropriations
Senate Committee on Ways & Means

Background:

A vested member of the Public Employees' Retirement System (PERS) or the School Employees' Retirement System (SERS) Plans 2 or 3 may retire with an unreduced defined benefit at age 65. At retirement in Plan 2 a member receives 2 percent of the member's final average salary for each year of credited service. In Plan 3, a member receives 1 percent of the member's final average salary for each year of credited service and may withdraw his or her accumulated member contributions and earnings.

A member of the PERS or the SERS Plan 2 may apply for early retirement after 20 years of credited service beginning at age 55. A member of the PERS or the SERS Plan 3 may apply for early retirement after 10 years of credited service beginning at age 55. If a member in Plan 2 or Plan 3 applies for early retirement with less than 30 years of service, his or her benefit is actuarially reduced for the member's age difference at retirement and age 65. This actuarial reduction typically averages about 8 percent per year. A member who applies for early retirement with 30 or more years of service has his or her benefit reduced instead by 3 percent per year.

Members of the PERS and the SERS generally have the opportunity to participate in deferred compensation plans. These plans permit an individual to place a portion of salary into a special account prior to being subject to payroll tax reductions. The Department of Retirement Systems (DRS) operates a deferred compensation program consistent with the federal tax requirements of 26 United States Code section 457, commonly called a "457 Plan", in which employees of the state, counties, municipalities and other political subdivisions may participate. Some school districts and local governments may also

participate in other deferred compensation-type plans commonly referred to as "403(b)" or "401(k)" plans. Individuals may also be able to deposit funds into accounts with preferential tax treatment such as Individual Retirement Accounts (IRAs).

In recent years, changes in federal law have liberalized the rules on the transfer of funds between tax-deferred accounts, including government defined benefit pension plans like the PERS and the SERS, and deferred compensation accounts such as 457, 403(b), and 401(k) plans. Many state and local government pension plans have subsequently provided the opportunity for members to transfer funds, including funds from tax-deferred accounts, into these plans to add up to five years of service credit to a member's defined benefit.

Summary:

A member who applies for early retirement in the PERS or the SERS Plan 2 or 3 may, at the time of retirement, file an application with the DRS to purchase up to five years of additional service credit. The cost of the additional service credit is the actuarial equivalent value of the resulting increase in the member's benefit.

The member may pay all or part of the cost of the additional service credit with an eligible transfer from a qualified retirement plan. The DRS must adopt rules to ensure that all purchases and transfers comply with the requirements of the federal Internal Revenue Code and regulations.

Additional purchased service credit is not regular membership service credit and may not be used to qualify a member for the 3 percent per year early retirement reduction available to members of the PERS and the SERS Plans 2 or 3 with 30 years of service.

Votes on Final Passage:

House 94 -0
Senate 47- 0

Effective: July 1, 2006

RCW 41.50.088

Employee retirement benefits board -- Duties.

(1) The board shall adopt rules as necessary and exercise the following powers and duties:

(a) The board shall recommend to the state investment board types of options for member self-directed investment in the teachers' retirement system plan 3, the school employees' retirement system plan 3, and the public employees' retirement system plan 3 as deemed by the board to be reflective of the members' preferences;

(b) By July 1, 2005, the board shall make optional actuarially equivalent life annuity benefit payment schedules available to members and survivors that may be purchased from the combined plan 2 and plan 3 funds under RCW 41.50.075; and

(c) Determination of the basis for administrative charges to the self-directed investment fund to offset self-directed account expenses;

(2) The board shall recommend to the state investment board types of options for participant self-directed investment in the state deferred compensation plan, as deemed by the board to be reflective of the participants' preferences.

[2000 c 247 § 602. Prior: 1998 c 341 § 507; 1998 c 116 § 10; 1995 c 239 § 302.]

NOTES:

Effective dates -- Subchapter headings not law -- 2000 c 247: See RCW 41.40.931 and 41.40.932.

Effective date -- 1998 c 341: See note following RCW 41.34.060.

Intent -- Purpose -- 1995 c 239: See note following RCW 41.32.831.

Effective date -- Part and subchapter headings not law -- 1995 c 239: See notes following RCW 41.32.005.

Benefits not contractual right until date specified: RCW 41.34.100.

RCW 41.32.067

Purchase of additional benefits -- Conditions.

A member may purchase additional benefits subject to the following:

- (1) The member shall pay all reasonable administrative and clerical costs; and
- (2) The member shall make a member reserve contribution to be actuarially converted to a monthly benefit at the time of retirement.

[1992 c 212 § 13; 1991 c 278 § 2.]

WAC 415-02-340 Monthly benefit per \$1.00 of accumulation for defined benefit plans.

(1) How does the department use the information in the table called "monthly benefit per \$1.00 of accumulation for defined benefit plans"? The department uses this information to:

- (a) Determine what a future lifetime monthly benefit is worth in present-day dollars;
 - (b) Determine the equivalent value of a lump sum when compared with monthly payments;
- and

(c) Reduce the monthly retirement benefit in TRS Plan 1 if you take a lump sum cash out for some or all of your funds.¹

(2) What type of information is in this table? The information in this table reflects the expected duration of lifetime payments for recipients over a range of ages. These values differ by system and plan, and all reflect an assumed rate of return of 8.0%.²

(3) Examples

(a) Example (a):

Celina is a 65-year-old PERS Plan 2 member who is eligible to receive \$45.00 per month. She wants to know how much money she could receive if she accepted a lump sum payment instead. Celina looks at the row in the table for age 65 in the PERS Plan 2 column and learns that \$0.0072458 per month for life is equivalent to one dollar in cash for this system, plan, and age class. Celina divides \$45.00 by 0.0072458 and learns that her lump sum payment would be \$6,210.49.

(b) Example (b):

Fred is a 58-year-old TRS Plan 1 member. The balance in Fred's account is \$124,934.00. Upon retirement, Fred chooses to withdraw the \$124,934.00 (as only members of TRS Plan 1 can do). From the row in the table for age 58 in the TRS Plan 1 column, Fred learns that \$0.0077573 per month for life is the equivalent to one dollar in cash for this system, plan, and age class. Fred multiplies the lump sum cash-out amount of \$124,934.00 by 0.0077573, and learns that his monthly retirement will be reduced by \$969.15 per month because of the lump sum cash out made at retirement.

(4) Table - Monthly benefit per \$1.00 of accumulation for defined benefit plans:

Based on the 1995-2000 actuarial experience study monthly benefit per \$1.00 of accumulation defined benefit (DB) single life pension:

Age	LEOFF 1	LEOFF 2	PERS 1	PERS 2/3	SERS 2/3	TRS 1	TRS 2/3	WSPRS 2
20	0.0039835	0.0043310	0.0065444	0.0043102	0.0042786	0.0065267	0.0042774	0.0043319
21	0.0039997	0.0043459	0.0065518	0.0043243	0.0042911	0.0065329	0.0042897	0.0043469
22	0.0040168	0.0043615	0.0065598	0.0043390	0.0043042	0.0065396	0.0043027	0.0043626
23	0.0040347	0.0043780	0.0065684	0.0043546	0.0043181	0.0065468	0.0043165	0.0043791
24	0.0040535	0.0043955	0.0065778	0.0043710	0.0043327	0.0065546	0.0043309	0.0043966
25	0.0040734	0.0044139	0.0065878	0.0043884	0.0043481	0.0065630	0.0043462	0.0044150
26	0.0040943	0.0044333	0.0065987	0.0044067	0.0043644	0.0065720	0.0043622	0.0044346
27	0.0041163	0.0044539	0.0066105	0.0044261	0.0043816	0.0065818	0.0043792	0.0044552

¹ This option is only available in TRS Plan 1.

² The younger a person is, the longer the anticipated lifetime of payments would be, and the greater the sum required to provide for these payments. Put another way, the amount of monthly lifetime benefit that a present-day dollar buys goes up as the remaining life expectancy of the recipient goes down.

Age	LEOFF 1	LEOFF 2	PERS 1	PERS 2/3	SERS 2/3	TRS 1	TRS 2/3	WSPRS 2
28	0.0041396	0.0044757	0.0066232	0.0044466	0.0043997	0.0065924	0.0043971	0.0044771
29	0.0041641	0.0044988	0.0066370	0.0044682	0.0044189	0.0066038	0.0044161	0.0045002
30	0.0041899	0.0045231	0.0066517	0.0044911	0.0044391	0.0066162	0.0044361	0.0045246
31	0.0042171	0.0045488	0.0066676	0.0045152	0.0044605	0.0066295	0.0044572	0.0045503
32	0.0042456	0.0045758	0.0066845	0.0045405	0.0044830	0.0066438	0.0044795	0.0045774
33	0.0042755	0.0046042	0.0067025	0.0045672	0.0045067	0.0066592	0.0045031	0.0046059
34	0.0043069	0.0046340	0.0067217	0.0045952	0.0045316	0.0066756	0.0045278	0.0046358
35	0.0043398	0.0046654	0.0067421	0.0046247	0.0045578	0.0066930	0.0045539	0.0046672
36	0.0043745	0.0046984	0.0067639	0.0046558	0.0045854	0.0067116	0.0045812	0.0047004
37	0.0044109	0.0047333	0.0067873	0.0046886	0.0046145	0.0067315	0.0046101	0.0047353
38	0.0044494	0.0047701	0.0068123	0.0047233	0.0046452	0.0067527	0.0046404	0.0047723
39	0.0044900	0.0048091	0.0068393	0.0047600	0.0046777	0.0067754	0.0046725	0.0048114
40	0.0045330	0.0048505	0.0068682	0.0047988	0.0047120	0.0067998	0.0047065	0.0048529
41	0.0045784	0.0048944	0.0068994	0.0048400	0.0047483	0.0068261	0.0047423	0.0048969
42	0.0046266	0.0049409	0.0069329	0.0048837	0.0047868	0.0068543	0.0047803	0.0049436
43	0.0046777	0.0049904	0.0069690	0.0049300	0.0048275	0.0068846	0.0048206	0.0049932
44	0.0047319	0.0050430	0.0070078	0.0049791	0.0048706	0.0069172	0.0048632	0.0050460
45	0.0047894	0.0050989	0.0070495	0.0050312	0.0049163	0.0069523	0.0049084	0.0051021
46	0.0048504	0.0051584	0.0070945	0.0050866	0.0049647	0.0069900	0.0049562	0.0051617
47	0.0049153	0.0052218	0.0071429	0.0051455	0.0050161	0.0070305	0.0050070	0.0052253
48	0.0049844	0.0052894	0.0071953	0.0052082	0.0050707	0.0070740	0.0050609	0.0052932
49	0.0050581	0.0053617	0.0072519	0.0052752	0.0051287	0.0071210	0.0051183	0.0053657
50	0.0051368	0.0054390	0.0073132	0.0053466	0.0051905	0.0071717	0.0051793	0.0054432
51	0.0052210	0.0055218	0.0073796	0.0054231	0.0052564	0.0072265	0.0052444	0.0055264
52	0.0053104	0.0056098	0.0074510	0.0055044	0.0053265	0.0072858	0.0053139	0.0056147
53	0.0054060	0.0057042	0.0075283	0.0055914	0.0054014	0.0073500	0.0053881	0.0057094
54	0.0055084	0.0058054	0.0076121	0.0056846	0.0054813	0.0074191	0.0054671	0.0058110
55	0.0056182	0.0059141	0.0077029	0.0057845	0.0055668	0.0074939	0.0055515	0.0059201
56	0.0057354	0.0060302	0.0078008	0.0058912	0.0056581	0.0075749	0.0056420	0.0060367
57	0.0058601	0.0061539	0.0079058	0.0060049	0.0057557	0.0076627	0.0057388	0.0061608
58	0.0059937	0.0062865	0.0080192	0.0061265	0.0058600	0.0077573	0.0058422	0.0062940
59	0.0061368	0.0064287	0.0081415	0.0062566	0.0059712	0.0078589	0.0059524	0.0064368
60	0.0062900	0.0065812	0.0082732	0.0063959	0.0060901	0.0079685	0.0060703	0.0065898
61	0.0064540	0.0067444	0.0084149	0.0065448	0.0062172	0.0080866	0.0061963	0.0067538
62	0.0066294	0.0069191	0.0085668	0.0067036	0.0063529	0.0082138	0.0063311	0.0069292
63	0.0068167	0.0071058	0.0087294	0.0068729	0.0064976	0.0083506	0.0064751	0.0071168
64	0.0070165	0.0073050	0.0089030	0.0070531	0.0066517	0.0084970	0.0066285	0.0073169
65	0.0072307	0.0075186	0.0090893	0.0072458	0.0068158	0.0086537	0.0067919	0.0075315
66	0.0074600	0.0077474	0.0092891	0.0074517	0.0069903	0.0088208	0.0069657	0.0077614
67	0.0077052	0.0079921	0.0095028	0.0076715	0.0071765	0.0090000	0.0071514	0.0080073
68	0.0079692	0.0082556	0.0097332	0.0079076	0.0073755	0.0091921	0.0073497	0.0082721
69	0.0082539	0.0085400	0.0099823	0.0081620	0.0075879	0.0093974	0.0075612	0.0085580
70	0.0085622	0.0088479	0.0102523	0.0084366	0.0078162	0.0096186	0.0077883	0.0088676
71	0.0088938	0.0091793	0.0105419	0.0087308	0.0080615	0.0098577	0.0080327	0.0092008
72	0.0092539	0.0095393	0.0108558	0.0090487	0.0083261	0.0101166	0.0082964	0.0095628
73	0.0096446	0.0099300	0.0111955	0.0093919	0.0086093	0.0103939	0.0085784	0.0099559
74	0.0100684	0.0103538	0.0115628	0.0097624	0.0089142	0.0106939	0.0088826	0.0103824
75	0.0105280	0.0108135	0.0119604	0.0101627	0.0092422	0.0110180	0.0092104	0.0108451

Age	LEOFF 1	LEOFF 2	PERS 1	PERS 2/3	SERS 2/3	TRS 1	TRS 2/3	WSPRS 2
76	0.0110267	0.0113124	0.0123914	0.0105960	0.0095951	0.0113678	0.0095637	0.0113472
77	0.0115688	0.0118547	0.0128599	0.0110662	0.0099757	0.0117460	0.0099450	0.0118933
78	0.0121597	0.0124460	0.0133705	0.0115778	0.0103875	0.0121558	0.0103575	0.0124885
79	0.0128051	0.0130919	0.0139278	0.0121352	0.0108344	0.0126012	0.0108049	0.0131389
80	0.0135111	0.0137984	0.0145368	0.0127433	0.0113202	0.0130863	0.0112914	0.0138505
81	0.0142843	0.0145725	0.0152030	0.0134074	0.0118492	0.0136157	0.0118211	0.0146303
82	0.0151240	0.0154130	0.0159279	0.0141293	0.0124242	0.0141938	0.0123986	0.0154769
83	0.0160353	0.0163252	0.0167162	0.0149136	0.0130497	0.0148256	0.0130286	0.0163958
84	0.0170241	0.0173149	0.0175726	0.0157650	0.0137302	0.0155137	0.0137139	0.0173927
85	0.0180966	0.0183884	0.0185016	0.0166876	0.0144701	0.0162628	0.0144589	0.0184740
86	0.0192583	0.0195513	0.0195059	0.0176841	0.0152736	0.0170771	0.0152680	0.0196456
87	0.0205119	0.0208062	0.0205851	0.0187541	0.0161432	0.0179605	0.0161446	0.0209102
88	0.0218550	0.0221507	0.0217347	0.0198932	0.0170791	0.0189147	0.0170905	0.0222656
89	0.0232781	0.0235752	0.0229444	0.0210916	0.0180779	0.0199388	0.0181048	0.0237021
90	0.0247625	0.0250609	0.0241977	0.0223336	0.0191323	0.0210275	0.0191823	0.0252008
91	0.0262789	0.0265782	0.0254717	0.0235975	0.0202301	0.0221705	0.0203134	0.0267317
92	0.0278427	0.0281429	0.0267640	0.0248804	0.0213620	0.0233525	0.0214834	0.0283116
93	0.0294384	0.0297392	0.0280581	0.0261661	0.0225126	0.0245532	0.0226729	0.0299249
94	0.0310505	0.0313517	0.0293389	0.0274402	0.0236656	0.0257646	0.0238739	0.0315562
95	0.0326651	0.0329665	0.0305940	0.0286908	0.0248057	0.0269704	0.0250708	0.0331914
96	0.0342704	0.0345719	0.0318149	0.0299099	0.0259197	0.0281559	0.0262493	0.0348186
97	0.0358572	0.0361585	0.0329987	0.0310951	0.0269980	0.0293096	0.0273986	0.0364281
98	0.0374173	0.0377185	0.0341503	0.0322517	0.0280348	0.0304239	0.0285118	0.0380114
99	0.0389423	0.0392433	0.0352857	0.0333956	0.0290309	0.0314979	0.0295884	0.0395582

[Statutory Authority: RCW 41.50.050(5) and chapter 41.45 RCW. 02-18-048, § 415-02-340, filed 8/28/02, effective 9/1/02.]